



The Commonwealth of Massachusetts
Office of the Commissioner of Banks
One South Station
Boston, Massachusetts 02110

JANE SWIFT
GOVERNOR

THOMAS J. CURRY
COMMISSIONER

April 19, 2002

Paul D. Snyder, Senior Regional Attorney
Federal Deposit Insurance Corporation
15 Braintree Hill Office Park
Braintree, Massachusetts 02184

Dear Mr. Snyder:

This letter is in response to your correspondence dated March 22, 2002 to the Division of Banks (the "Division") relative to the law governing the total obligations of one borrower to a Massachusetts chartered bank. The statute is section 14 ("Section 14") of chapter 167E of the General Laws. That law consists of five subsections as follows. Subsection A governs the aggregate limit on loans to one borrower by a bank in stock form while Subsection B governs the aggregate limit for a bank in mutual form. Subsections C, D and E generally provide exceptions from the calculation of the aggregate loan limit. Your letter raises three questions relative to the computation of capital on which the aggregate loan limitation is based. As noted in your letter, these questions have been discussed over time in various telephone conversations. This request seeks to formalize the Division's ruling on each matter rather than to rely on your understanding of the Division's position from those telephone conversations. The letter reflects your understanding of those discussions.

The first question you ask is at what point in time would the Division calculate capital for purposes of determining compliance with the Section 14 limit. The Division's position is that the most recently available calculation of capital to the time of the making of the loan would be determinative of whether the loan was legal when made. The most recently available calculation would cover any calculation regardless of whether it was made for public or internal purposes. Moreover, the Division would expect a bank to know its aggregate loan limitation on a regular basis. This position is consistent with your understanding of our telephone discussions.

The second question relates to the Division's position on requiring a bank to mark its securities to market in accordance with FAS 115. The Division's position in calculating the aggregate loan limit is to disregard the change in value of securities available for sale. The Division's position on this issue was set out in a Memorandum, dated February 7, 1997, to Financial Supervision



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Examination and Management Staff entitled "Legal Lending Limit Calculations under FAS 115," enclosed. This position is generally consistent with your understanding of our telephone conversation, however, the Division would not value the bank's securities at their purchase price, as referenced in your letter.

The third question concerns the correlation between the accounting categories for calculating the base for determining the aggregate limit on loans to one borrower which exists in Section 14 relative to the categories which exist in 12 C.F.R. Part 325.

As discussed in our telephone conversations Section 14 includes in that calculation for a bank in stock form the following: "capital stock" at par value; the "surplus account" which would include the original difference between the par value of the stock and its selling price; and "undivided profits." It should be noted that surplus would also include any other funds transferred to that account by the bank. As set out in your letter, you believe these statutory categories correspond to the accounting categories on a bank's balance sheet in accordance with 12 C.F.R. Part 325 as follows:

Section 14

"capital stock"
"surplus account"
"undivided profits"

Part 325

"common stock"
"additional paid in capital"
"net profit or loss" as well
as "retained earnings"

The Division agrees that the statutory categories discussed herein do correspond to the above cited accounting categories used to determine a bank's' capital position on its balance sheet in accordance with Part 325.

As presented here and in our telephone conversations the Division's responses to your questions have been discussed with examination personnel and staff of the Financial Supervision Unit.

The conclusions reached in this letter are based solely on the facts presented. Fact patterns which vary from that presented may result in a different position statement by the Division.

Sincerely,



Joseph A. Leonard, Jr.
Deputy Commissioner of Banks
and General Counsel

MEMORANDUM

TO: FIS Examination and Management Staff
FROM: Thomas J. Curry, Commissioner of Banks
SUBJECT: Legal Lending Limit Calculations under FAS 115
DATE: February 7, 1997

Questions have been posed by both field examiners and bankers as to whether FAS 115 adjustments should be included as part of the definition of capital when determining legal lending limits. This memorandum contains an official determination of Division policy since the law apparently does not address this specific issue. This issue has arisen at several bank examinations at which examiners required proper guidance.

Background

Chapter 167E paragraph 14 provides lending limits using various capital categories, including capital stock, surplus and undivided profits. Since the writing of this law, a new FAS accounting treatment regarding recognizing unrealized gains/losses on available-for-sale (AFS) securities has been adopted. Under FAS 115 rules, unrealized gains/losses are recognized on the balance sheet by reporting AFS securities at market value with a direct after-tax offsetting adjustment to capital. When the law was written, FAS 115 was not in existence.

Issues Considered

If included in capital, the FAS 115 accounting treatment could result in significant fluctuations in the level of capital and, therefore, the legal lending limit. This can lead to burdensome administrative situations in tracking whether loans were within the legal lending limit at the time they were made and how it affects refinances/advances of new funds.

By not including the unrealized gains/losses, the true "value" of capital is not being considered, and would result in a GAAP/RAP difference. Please note that the FDIC's Part 325 capital regulations specifically do not include the unrealized gains/losses on AFS securities, with the exception of unrealized losses on marketable equity securities. However, there are other similar situations where true "market value" is not accounted for in capital, so the question remains as to whether there is the need to apply this rule for state law purposes.

Policy

The Division's policy is that examiners and bank lending officers should ignore the impact of FAS 115 adjustments in calculating legal lending limits for the following reasons.

1. The capital base ignoring the FAS 115 adjustments still provides reasonable limits to protect against undue levels of concentrations by one borrower.
2. The administrative burden on banks will be more reasonable.
3. When the law was written, this accounting treatment was not in effect.

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